THE WHITE HOUSE

WASHINGTON

August 5, 1981

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the August 6 Meeting

The agenda and papers for the Thursday, August 6 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The first agenda item is an update on the economic and financial situation in Poland. State and Treasury will jointly present a report on recent developments in the Polish economic and financial situation. A memorandum on the economic situation in Poland and on burden sharing by creditor nations is attached.

The second agenda item is a report on the preparatory meetings for the Cancun Summit scheduled for the third week in October. State and Treasury will jointly present a report on the meetings held last weekend in Cancun. A short paper from Assistant Secretary Leland is attached.

The third agenda item relates to international investment policy. A memorandum from Assistant Secretary Leland who chairs the Council's Working Group on International Investment is attached. His report will focus on the initial stages of the working group's consideration of potential problems of foreign government controlled investments in the United States, the Committee on Foreign Investment in the United States' (CFIUS) review of Elf Aquitaine's takeover of Texasgulf, and recent suggestions for modifying the mandate of the CFIUS.

Attachments

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DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

August 5, 1981

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: Marc E. Leland

SUBJECT: Polish Financial Situation

Attached for the Cabinet Council's discussion of Poland is a background memorandum on the Polish financial situation along with an attachment on the appropriate U. S. share of financial assistance to Poland.

Attachment

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August 4, 1981

POLISH FINANCIAL SITUATION IN 1981 AND 1982

This paper, provides analysis and background for your meeting on Poland. It describes Poland's external financing needs in 1981 and 1982, the pressures on the USG to provide additional assistance, and alternative scenarios for providing such assistance. It must be emphasized however, that the paper does not address the primary and fundamental question of whether the USG should participate in a long-term economic assistance program. Such a decision will, of necessity, require considerably more analysis and discussion of the complex political, economic, security, and budgetary considerations involved. It is important, however, to begin now to explore the issues involved in the question of how the USG would provide additional assistance so that, if the decision is made to move ahead, the ground work has been laid. The timing of assistance to Poland will be crucial; we must make contingency plans now to assure that any future decision can be implemented in time to achieve maximum results.

A paper considering the question of burden sharing in financial assistance to Poland is attached.

Poland's External Financing Needs in 1981

Much of Poland's foreign financing need in 1981 of $11.7 billion has been met by Western creditor groups through rescheduling, credits already granted, or freezing of principal repayments on private bank credits. Financing of $9.5 billion has already been arranged, although all of it has not yet been utilized, especially lines of credit with Western European governments. Many of these are export credit lines that require cash downpayments which the Poles cannot meet. Furthermore, about $1.1 billion of the outstanding $1.6 billion of undrawn European export credits are tied to purchases of capital goods. These credits probably will not be utilized. The U.S., with $731 million, ($585 million in CCC guarantees, $20 million in Ex-Im Bank credit, $71 million Surplus Dairy Products sale and $55 million of PL 480 corn sales)

Classified by R.A. Cornell
Review for Declassification on 7-31-87

is the single largest contributor of official credits so far this year. (The USG also provided $86 million of bridge financing by deferring debt repayments due us for one year.)

The remaining financing gap is in the range of $2.2 billion. Given the already sizable U.S. contribution this year, particularly in view of our relatively smaller financial and economic ties with Poland, the U.S. position has been that the remaining gap should be filled by the Europeans and Soviets.

Neither the Europeans nor the Soviets have shown much enthusiasm for further credits. European performance on credits this year has been particularly disappointing. The major European participants in Polish creditor meetings have pledged slightly less than $1.2 billion.

At the last creditor meeting on Poland June 1-2, France was the only country to offer further credits -- and this offer only amounted to $60 million. We estimate that U.S.S.R. and other CEMA countries provided $700 million in the first quarter of 1981, but hard figures are not available. Evidence is mounting that the U.S.S.R. has been increasing its assistance in kind this year, through growing Polish trade deficits with the Soviets. The Poles claim CEMA has decided against providing further hard currency assistance in 1981.

recent [illegible] in own credits more for food [illegible] 2/21 EC comments

Our latest information on responses to the Delors proposal to the 16 creditor countries that they cooperate through the BIS to provide short-term credit facilities to the Poles is that only the Swiss have come forward, with an offer of $50 million. France proposes to offer up to $125 million.

Table 1: POLAND'S FINANCING GAP IN 1981

	(billions)
Current Account Deficit	$3.4
Amortization	7.5
Credits Extended	0.2
Short-Term Capital Flight	0.6
Gross Financing Needs	$11.7
Sources of Financing	
Already in Place	
Official Rescheduling (Paris Group)	$2.9
Western Export Credits (including 731 million from U.S.)	1.8
Socialist Assistance (First Quarter)	0.7
Western Financial Credits (U.S. Bridge Financing)	0.1
Subtotal	$5.5

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Expected	
Private Rescheduling	$2.4
Undrawn European Export Credits	1.6
Subtotal	$4.0
Financing Gap	$2.2

If Poland does not close the existing financing gap, its ability to import will be limited to the level of hard currency export earnings, as has been the case in recent months. This level of imports may provide adequate food, spare parts and raw materials to keep the economy functioning at current low and near-crisis levels. The more likely result, however, is that the Polish economy will continue its current downtrend during which industrial production has declined by 12.5 percent between January and June 1981. There is no basis for determining how long this decline in output could continue before a crisis emerges, but the decline already has been more precipitous than most observers thought sustainable as little as a year ago.

Poland's Hard Currency Financing Needs in 1982

Assuming Poland succeeds in obtaining the necessary financing in 1981 and in balancing its trade account with the west in 1982 with imports of $7.5 billion, its gross hard currency financing needs will decline by nearly 18 percent to about $9.3 billion. If the official creditors again reschedule 90 percent of the principal and interest due them and the private creditors reschedule 95 percent of principal payments due to them, Poland's 1982 financing gap will be reduced to $2.6 billion.

a 70% increase in imports

Any new credits provided Poland without a minimum of three or four years' grace will complicate its financing problems and perhaps its economic recovery. In order simply to eliminate its ongoing need to borrow, Poland will have to have a trade surplus large enough to bring its current account into balance. For example, in 1981 this would require a 53 percent increase in exports. Current projections suggest the Poles might achieve that result only by 1986. Therefore, Poland will have to fill the gap by credits from western official sources and the CEMA countries. It is questionable whether western banks will provide significant additional long term financing until they are convinced Poland is clearly on the road to economic recovery.

Table 2: POLAND'S FINANCING GAP IN 1982

	(billions)
Current Account Deficit	$3.0
Amortization	6.0
Credits extended	0.3
Gross Financing Needs	$9.3

Sources of Financing

Official Rescheduling	$3.8
Private Rescheduling	2.9
Subtotal	$6.7
Financing Gap	$2.6

In summary, Poland's gross hard currency financing needs for 1981 and 1982 are estimated at $20 billion. Subtracting the $12 billion of debt rescheduling relief western creditors are expected to provide Poland will need about $8 billion in new financing during this period. A paper at Tab A considers the question of what should be the appropriate U.S. share of this burden. If a 10, 15 or 20 percent share is chosen the financing assistance provided by the USG should total $800 million, $1.2 billion or $1.6 billion respectively. To date the USG has provided $731 million.

Whatever the amount to be provided it would be counterproductive for the repayment terms not to include a grace period of sufficient length to prevent another debt repayment mountain from developing.

"Burden Sharing" in Financial Assistance to Poland

The question of what is the appropriate U.S. share of financial assistance can be considered in terms of the importance of U.S. economic and financial relations with Poland relative to other countries. The attached table provides country shares of those relations for the U.S., fourteen other western creditor countries and some data for the USSR.

The United States has already provided Poland with $731 million in official or officially supported credits, including the recent $55 million in corn sales under PL 450. Total credits to Poland by the western creditor governments so far this year is estimated at $3.4 billion. Of that $1.8 billion has been utilized and $1.6 billion remains undrawn largely because funds are tied to capital goods which Poland no longer plans to purchase.

Out of the total $3.4 billion the U.S. credits of $731 million represent 21.5 percent. This compares with a 10.9 percent U.S. share for total Polish trade as shown in the attached table.

8/4/81

Country Shares

in percent, based on:

	Polish Trade 1978-80			Total Foreign Debt with Market Economies[1]		Government Credits[2]		GNP Weights (OECD 197?
	Imports	Exports	Total Trade	Outstanding 12/31/80	Maturing 1981-83	Outstanding 12/31/80	Maturing 1981-83	
EEC	57.6	66.4	61.3	59.4	53.6	67.5	53.2	37.!
Belgium	3.1	3.2	3.1	2.3	3.0	1.5	2.1	1.
Denmark	1.3	4.9	2.9	1.0	0.7	0.3	0.4	1.
France	10.5	10.3	10.4	13.6	14.2	10.0	16.2	9.(
Germany	19.1	24.8	21.6	23.8	18.6	29.7	16.9	12.(
Italy	6.3	9.2	7.5	5.5	6.0	8.1	4.7	5.(
Netherlands	4.6	3.3	4.0	2.2	2.6	1.8	2.7	2.
UK	12.7	10.7	11.8	11.0	8.5	16.1	10.2	6.
Other Europe	22.3	21.3	21.7	15.7	19.4	14.4	18.7	5.
Austria	9.3	4.8	7.3	9.3	11.6	9.1	12.5	1.
Finland	0.9	4.1	2.2	0.2	0.2	0.1	0.5	0.
Norway	1.2	2.1	1.6	0.4	0.5	0.5	0.6	0.
Sweden	4.7	5.1	4.8	2.6	3.4	2.7	3.4	1.
Switzerland	6.2	5.2	5.8	3.2	3.7	2.0	1.7	1.
Canada	3.4	1.6	2.6	3.6	3.8	4.4	4.3	3.
Japan	4.5	1.4	3.2	4.7	4.3	4.4	3.7	15.
Total 14 countries	87.9	90.6	88.8	83.5	81.2	90.5	79.8	62.
U.S.	12.1	9.4	10.9	16.5	18.8	9.5	20.2	37.
Total 15 countries	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.
USSR as % of total 15	95.2	117.9	105.1					21.

1 Polish Government data.
2 Creditor Government data, except for Austria and Finland which is GOP data.
Columns may not add to totals because of rounding.

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